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POLICY BRIEF

Senate Post Audit and Oversight Bureau
 Chair, Senator Cheryl A. Jacques

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STATE AND LOCAL GOVERNMENTS OWED AT LEAST \$574 MILLION IN OVERDUE DEBTS

- The Senate Post Audit and Oversight Bureau has identified at least \$574 million owed to municipalities and several state agencies. A Bureau survey of municipalities revealed that Massachusetts cities and towns are owed an estimated \$460 million, several state agencies are owed \$89 million and the Registry of Motor Vehicles (RMV) has identified more than \$25 million in overdue motor vehicle fines.
- This past year, the State Senate took the initiative to enhance debt collections by, among other things, allowing municipalities and authorities to use the State Comptroller's successful Intercept Program to collect on debts by capturing state payments and, through its partnership with the Department of Revenue (DOR), state income tax refunds. However, much remains to be done to improve collections.
- With the Commonwealth facing a projected \$2 billion deficit in fiscal year 2004 and municipalities dealing with serious budget shortfalls, state and local governments must work to collect every possible dollar owed. This policy brief lays out a strategy for local and state officials to aggressively collect these debts.

Background

Massachusetts is facing extraordinary budget difficulties. As a result of the economic downturn and declining tax revenue, state government may be faced with a \$2 billion deficit in fiscal year 2004. Local governments are facing equally challenging budget difficulties, with rising costs and stagnant revenues.

In December 2002, the Massachusetts Municipal Association summed up the budgetary situation for local governments succinctly in a news article headline: "Early outlook for fiscal 2004 is grim." The article underlined that state rainy day funds, once nearly \$2.3 billion, are almost exhausted and, consequently, cannot be used to bridge the chasm between state revenues and program obligations.

Though state and local governments are facing job cuts and service reductions to balance their budgets, Massachusetts citizens have a limited appetite for additional taxes. Therefore, legislators and policy makers must think creatively about finding the resources that can help preserve local aid and programs that provide a social safety net.

One potential source of funds for Massachusetts local governments is past-due real estate taxes, water and trash fees, police details, excise taxes, and other similar

municipal levies. A new Bureau survey of municipal debts reveals that Massachusetts cities and towns are owed an estimated \$460 million.

A Mountain of Debt

According to what may be the first comprehensive survey of debts owed to municipal governments, Massachusetts cities and towns are owed more than \$460 million in debts that are more than 90 days overdue.

During the summer of 2002, the Bureau completed a survey of Massachusetts local tax collectors and treasurers to document debts owed to municipalities. The Bureau specifically asked about the categories of real estate taxes, business and personal property taxes, water/sewer/trash fees, police detail fees, ambulance fees, motor vehicle excise taxes, and boat excise taxes. The survey did not ask collectors and treasurers about overdue parking or motor vehicle fines, since those debts are typically collected by other local officials.

The Bureau received 82 responses, representing communities containing 38% of the total Massachusetts population. The responding communities alone identified and documented debts totaling more than \$175 million dollars. As a result, the Senate Post Audit and Oversight Bureau extrapolated this data to estimate that Massachusetts cities and towns are owed more than \$460 million, not counting tens of millions of dollars more in overdue parking and motor vehicle fines.

Beyond the debts owed to municipal governments, state agencies are also owed huge sums. As of December 2002, 12 higher education campuses were owed more than \$14 million, and just four state agencies – the Division of Employment and Training, the Department of Public Health, the Group Insurance Commission, and the Secretary of State – were owed more than \$75 million, according to the Office of the State Comptroller. These state agencies have one thing in common: they do not participate in the State Comptroller's Intercept Program.

The Intercept Program allows the state to capture funds owed to the state by individuals or companies. Intercept is an automated system that matches delinquent debt owed by individuals or businesses to payments being made by the Commonwealth and DOR's Mass Tax system. The Intercept Program is fully integrated into the Commonwealth's Billing and Accounts Receivable System (BARS), a sub-system of the Massachusetts Management Accounting and Reporting System (MMARS). Whenever the Comptroller issues a check to either give a tax refund or pay for a service, the amount owed is subtracted from the refund or payment.

Over the past seven years, the Intercept Program has captured more than \$27 million for the 58 state agencies that have participated. Forty-three of these agencies use the Intercept Program and the underlying billing system (BARS) administered by the Office of the Comptroller; as a result overdue debts automatically receive four dunning notices and are then eligible for consideration in the Intercept Program. Fifteen institutions of higher education participate in the Intercept Program, using a new web-based system

that allows for entities that don't use BARS on a daily basis to process their approved debt against Commonwealth payment systems.

This automated system of collecting helps ensure that most state agencies do a reasonably good job of collecting on their debts.

Historical Perspective

In 1988, State Auditor Joe DeNucci published a seminal audit about non-tax revenue that determined that state agencies were failing to actively collect outstanding accounts receivable balances. As a result, the State Auditor identified more than \$300 million in potential enhanced revenues to Massachusetts state government.

By 1992, the Commonwealth had created a centralized automated billing and collection system, called BARS. BARS revolutionized billing and collecting for most state agencies, and successfully collected non-tax revenues of more than \$17.8 billion since 1992.

However, not all state agencies are required to participate in BARS, and consequently not all state agencies have revamped their billing and collection systems to effectively collect debts.

Recent History of Legislative Action

Last year, the Bureau worked closely with the Senate Committee on Ways and Means to incorporate into the state budget a number of initiatives to help municipalities and the state collect on unpaid debts. The Office of the State Comptroller and the Massachusetts Municipal Association were also partners in the reforms. Many of these ideas became law as part of the Commonwealth's fiscal year 2003 budget.

- In an effort to collect the identified debts at state agencies, the Legislature mandated that all higher education institutions and the five state agencies with large outstanding debts participate in the Intercept Program. In order to participate in the Intercept Program, all of these agencies will be required to take additional steps to improve their collection of debts.
- With the active support of the Office of the State Comptroller, the Legislature expanded the Intercept Program to allow the Comptroller to intercept funds on behalf of cities and towns, as well as authorities such as the Massachusetts Port Authority (MassPort), Massachusetts Turnpike Authority (MassPike) and the Massachusetts Bay Transportation Authority (MBTA). Municipalities and state authorities now have the ability to opt into the system.
- At the urging of the DOR, the Senate took the lead in allowing DOR to set up an aggressive discovery program to identify tax evaders who fail to properly report income. In addition, the Senate required DOR to seek to contract with a private vendor to enhance the department's capacity to identify unreported income and increase collection of taxes owed to the Commonwealth through the use of advanced software and efficient collection techniques.



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Sophisticated Solutions

Companies like American Management Systems (AMS), based in Virginia, offer sophisticated products to help states identify their potential tax debts and then aggressively collect on those debts. For example, a product called Strata for State Tax Collections uses sophisticated software to analyze tax histories and other data to identify high risk cases that should be treated more aggressively, prioritize caseloads by potential yield and restructure the work of tax collectors to maximize collections.

Other states have reaped the rewards of effective collection systems. In Virginia, AMS is credited with helping increase collections by \$118 million and continues to work with the state on this project. In Kansas, the company is credited with boosting collections by \$182 million over the life of a five-year project. Kansas continues to benefit from the reforms, but ceased tracking that data once the project was completed.

Moreover, states may choose to work with private vendors on a benefits basis, meaning that companies like AMS invest in whatever new hardware, software and equipment is needed to upgrade tax collections, and then the state pays them through the increased revenues that are generated.

- The Legislature also tried to streamline the collections process for unpaid parking tickets and auto excise taxes. By law, the RMV cannot renew the licenses or registrations of individuals who have outstanding debts for motor vehicle violations, parking violations and auto excise taxes. The RMV already successfully collects more than \$50 million for motor vehicle infractions and distributes these funds to municipalities. It is technologically feasible to also allow the RMV to collect unpaid parking tickets and auto excise taxes on behalf of municipalities. However, every year, the RMV has to turn away 150,000 customers at its counters because the agency has no statutory authority to collect these debts for municipalities. Unfortunately, Acting Governor Swift vetoed this proposal.
- Finally, as part of a reform of the auto franchise laws, the Legislature closed a loophole that made it nearly impossible for cities and towns to collect unpaid parking fines from people who either lease or rent vehicles. Prior to this reform, municipalities often could not get enough information from rental and leasing companies to be able to enforce the fine. Municipalities have lost significant revenue to the loophole. For example, Wellesley reported \$50,000 in uncollected parking fines for leased and rented vehicles, and another city reported uncollected parking fines for leased and rented vehicles of approximately \$180,000 every year.
- Led by the administration and legislative leaders like Senator Stanley Rosenberg, the Legislature passed legislation to create a one-time Tax Amnesty program, which opened a short window of time for tax delinquents to pay their overdue taxes without having to pay penalties. The Tax Amnesty program operated in

October and November 2002 and was able to generate approximately \$90 million from people who came forward to voluntarily pay overdue taxes.

Unfinished Business - Current Issues in Debt Collection

Despite these recent steps, there are still a number of unresolved issues related to debt collection.

Intercept Program

The fiscal year 2003 budget granted the State Comptroller the authority to collect debts for cities, towns and state authorities. However, before the Comptroller can begin to help collect on those hundreds of millions of dollars, the Office of the State Comptroller must make software changes, educate local leaders and recruit them to participate, and begin to aggressively collect that debt. The Comptroller is actively working to recruit cities and towns to the pilot initiative. In addition, MassPort, MassPike and the MBTA still do not participate in the Intercept Program.

Intercept Participation

The fiscal year 2003 budget also required higher education campuses and certain state agencies to participate in the Intercept Program. The House and Senate Ways and Means Committees should carefully review the progress that these agencies have made in collecting debts as the fiscal year 2004 budget is developed. There is at least \$75 million in uncollected debts owed to these departments.

Department of Revenue

Administrators for DOR will need to make the discovery program, which is designed to identify income tax evaders, a high priority, and must follow through on the mandate to formally explore whether the state can reap a windfall of tens of millions of dollars through a partnership with an outside vendor to enhance tax collections.

Registry of Motor Vehicles

Through a request by the Bureau, the RMV discovered that it had more than \$25 million in overdue fines for civil motor vehicle infractions; these fines are at least two years old. A concerted effort to collect on those fines would include participation in the Intercept Program and the use of contracted debt collectors. Under Registrar Kim Hinden, the RMV has begun the process of making necessary software changes to participate in the Intercept Program and hired debt collectors to pursue the worst offenders.

Streamline Collections at the RMV

As a result of Governor Swift's veto, each year the RMV is still forced to turn away 150,000 people from their counters because they have failed to pay auto excise taxes or parking fines. The RMV is still not empowered to collect those taxes and fines.

Auto Excise Taxes

Through a quirk in the law, city and town collectors are not able to directly place an individual who has not paid his or her auto excise tax on the RMV list that prohibits renewal without proof of payment. Instead, municipalities are forced to use privatized deputy collectors to physically serve collection warrants on someone before the RMV can prevent the renewal of someone's license or registration.

Debtor's List

City and town officials have one powerful tool at their disposal that is sometimes not used. Under M.G.L. ch. 40 § 57, municipalities can refuse to provide certain services, such as building permits, if the applicant owes a debt to the local government. The Bureau's survey suggests that a significant number of communities are not using this debt collection tool.

Showing the Way in Somerville

Like many communities, Somerville is wrestling with a large municipal deficit and the potential for serious cuts in public services like schools and public safety. As a result, the *Boston Globe* reported that Mayor Dorothy Kelly Gay launched an aggressive debt collection initiative designed to collect monies such as the \$3.7 million owed in overdue property taxes and \$1.3 million in unpaid water bills.

Using its authority under M.G.L. ch. 40 § 57, the City of Somerville is aggressively targeting tax evaders, threatening to discontinue water service to commercial structures and suspend municipal licenses until back taxes and unpaid bills are paid. In addition, hoping to shame individuals and businesses into paying their taxes, Somerville has begun to publish legal ads that warn delinquent taxpayers that nonpayment could result in liens on their property and eventual foreclosure. Recognizing the difficult economic times, Somerville is also allowing debtors to set up payment plans.

Since June 2002, when the collection strategy was launched, Somerville has collected more than \$600,000 in overdue debts. With the drastic fiscal environment forcing consideration of cuts in schools and public safety, Mayor Dorothy Kelly Gay knows that every dollar in revenue counts.

Parking Fines on Out-of-State Drivers

Many cities and towns near the state's borders report significant difficulty in enforcing parking fines against out-of-state drivers. Typically, parking fines are enforced through the RMV, because owners of vehicles with outstanding fines cannot renew their licenses or registrations until their parking fines are paid. However, out-of-state drivers are not affected by this technique. One option would be for the RMV to seek a reciprocity agreement with neighboring states, meaning that states like Rhode Island could enforce our parking fines and Massachusetts could enforce their fines.

Borderline Scofflaws

Massachusetts residents who fail to pay parking fines face a tough penalty – an inability to get their drivers' licenses or automobile registrations renewed. That penalty is the single most effective collection technique available to parking clerks and others responsible for trying to collect these fines.

However, residents of other states can usually ignore the fines because Massachusetts has not created cross-border reciprocity agreements that would allow neighboring states like Rhode Island to enforce our parking fines and vice versa.

In Attleboro, Massachusetts, for example, dozens of Rhode Island residents owe a total of tens of thousands of dollars in unpaid parking fines. These Rhode Island drivers can scoff at the parking tickets because they are not impacted by normal parking fine collection techniques involving the RMV. "In Massachusetts, the bell tolls at license renewal time, but in Rhode Island, it never tolls," said Jim Kern, Attleboro's Director of Budget and Administration, as quoted in the *Attleboro Sun Chronicle*.

New and Renovated Buildings

When buildings are constructed or renovated, there is often a significant delay between the completion of the project and the tax bill that reflects the new value of the property. Individual towns have begun to send out accurate tax bills as soon as the occupancy permit is issued, a change that is authorized under M.G.L. ch. 59 § 2D. However, cities and towns that want to assess properties in this way must go through a cumbersome process, including the need to get voter approval. This program is known as the Supplemental Assessment on New Construction.

Personal Property Taxes

A significant number of Massachusetts local collectors and treasurers identified personal property taxes as difficult to collect. Personal property taxes are owed on equipment and furniture in unincorporated businesses and on second homes. Unlike real estate property taxes, there is no clear enforcement mechanism that allows collectors to force payment.

Municipal Abandoned Property

Municipal governments have millions of dollars in so-called "abandoned property," such as unclaimed property or excise tax refunds, forgotten paychecks and un-cashed payments to vendors. In many communities, these funds just sit there. Communities should make a concerted effort to notify the owners of these funds and reclaim funds that have simply been abandoned, so that these funds can be used for general municipal purposes.

Findings

- Cities and towns in Massachusetts are owed an estimated \$460 million in overdue debts, without including tens of millions more in overdue parking and motor vehicle violation fines.
- Counting only a handful of state agencies, the Commonwealth is owed at least \$89 million in overdue debts, and the RMV has identified more than \$25 million in motor vehicle fines that are at least two years overdue.
- While improved debt collections alone cannot bridge the chasm between revenues and budget outlays, officials should take action to collect on every dollar possible to protect local aid and programs that provide a social safety net.

Recommendations for Administrative Action

- The new Governor has committed to drafting a balanced budget that does not increase taxes and minimizes cuts to human services and local aid. In pursuing that goal, Governor-elect Mitt Romney and other relevant officials should make debt collection a top priority.
 - Administrators at the Division of Employment and Training, Department of Public Health, Group Insurance Commission, and the Office of the Secretary of State should be charged with making sure that their agencies participate in the Intercept Program.
 - All public higher education institutions should begin to participate in the Intercept Program by July 2003.
 - The Office of the State Comptroller should make it a priority to implement the enhanced Intercept Program, including aggressively recruiting cities and towns to participate in the program.
 - The DOR should fulfill its statutory mandate to formally explore whether Massachusetts could reap tens of millions of dollars from a contract with a private firm to enhance collections and identify tax evaders.
 - The RMV should continue to work to aggressively collect the reported \$25 million in unpaid motor vehicle fines and to explore how it can work with other states to reciprocally help collect on parking fines.
 - MassPort, MassPike and the MBTA should be asked to report on overdue debts, and their boards should actively consider whether the authorities should use the Intercept Program to collect overdue debts.

Recommendations for Municipal Action

- Local elected officials should be aware that their communities often have hundreds of thousands or even millions of dollars in uncollected debts. Communities across the state should review these debts and develop aggressive strategies to collect that money.
- Local governments that have not adopted or are not enforcing M.G.L. ch. 40 §

57, which allows municipalities to deny services to debtors, should review whether utilizing the law makes sense in light of the budgetary problems ahead.

- The Massachusetts Collectors and Treasurers Association should assist the Legislature by developing a proposal to improve the collection of business and personal property taxes so that the Legislature can consider appropriate action during the fiscal year 2004 budget process.
- Local officials should ensure that people who have lost track of funds in the possession of municipalities, such as checks that were never cashed, are properly notified. If those funds have indeed been abandoned, then officials should go through the process to have the funds reverted to the municipality.

Recommendations for Legislative Action

- The Legislature should streamline collections by empowering the RMV to collect parking fines and overdue auto excise bills at its counters.
- Municipalities should be allowed to directly mark drivers' licenses as non-renewable, instead of being forced to rely on private deputy collectors to physically serve collection warrants before enforcing auto excise bills through the RMV.
- Rather than having to go through a cumbersome approval process to begin sending out accurate property tax bills, municipalities should automatically be granted the authority to send out accurate property tax bills for newly constructed or renovated buildings. Municipal leaders should still have the option of opting out of the Supplemental Assessment Program if they feel that it would not benefit their community.
- The Legislature should allow municipalities to modernize the process of publicizing and reclaiming abandoned property by allowing communities to post notification of unclaimed funds online and clarifying the procedures through which those funds revert to the municipality.

For more information, contact Senator Cheryl Jacques, Chair of the Senate Post Audit and Oversight Committee, at either cjacques@senate.state.ma.us or (617) 722-1555. The Bureau would like to acknowledge the assistance of Elizabeth Wilmot from the Kennedy School of Government, Krista Stark from the BU School of Public Health, Diane Ledwell and Kevin Moran from the Office of the State Comptroller, Nils Norsberg from the Massachusetts Association of Collectors and Treasurers, Paul Savoy from the RMV, and Catharine Hornby and Sam Cohen from the Senate Committee on Ways and Means. In addition, the Bureau would like to recognize the Massachusetts Municipal Association and the Massachusetts Association of Collectors and Treasurers for their participation in this project.

